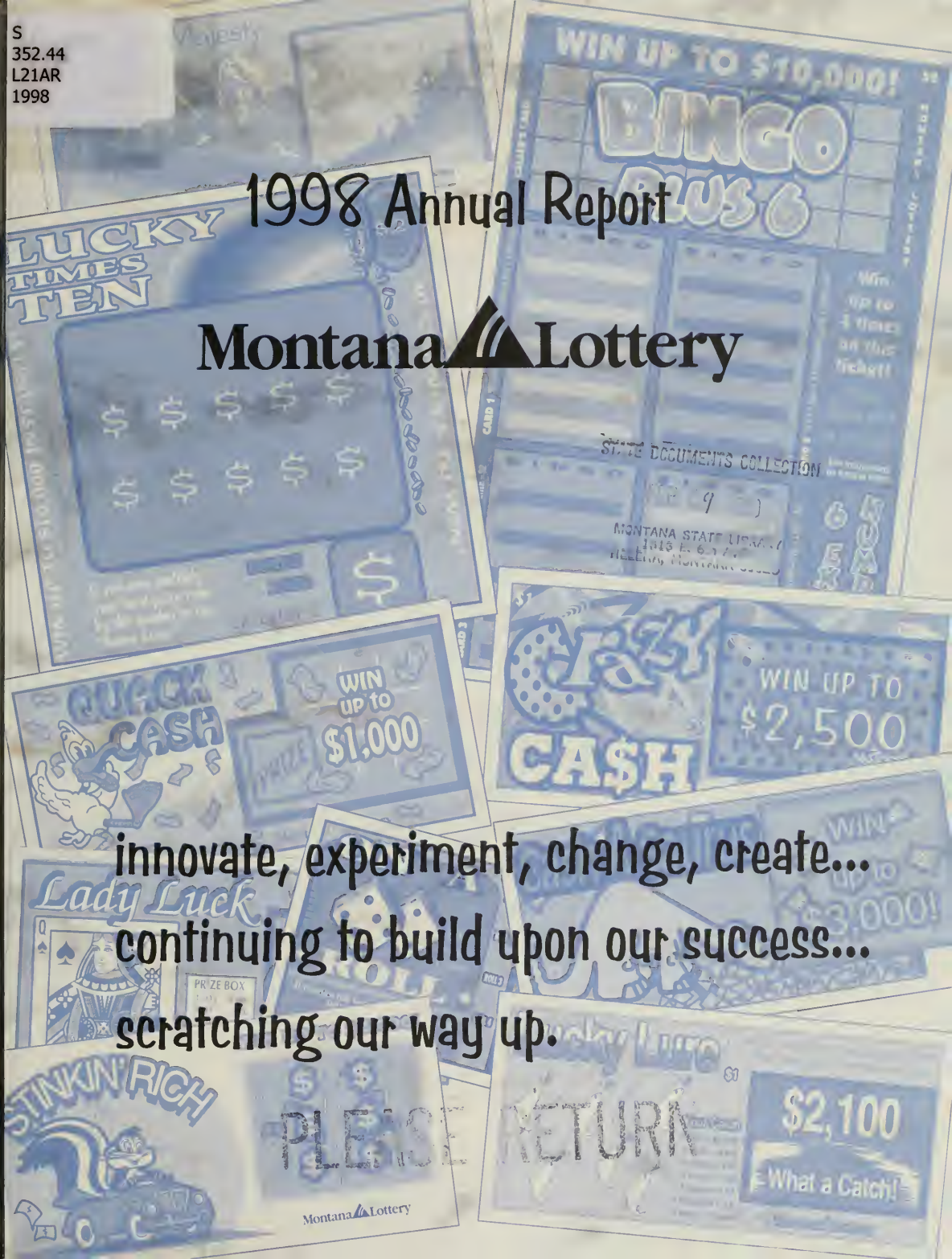


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1998 Annual Report

Montana Lottery

innovate, experiment, change, create...
continuing to build upon our success...
scratching our way up.



MONTANA STATE LIBRARY



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Director's Message



The Montana Lottery means different things to many different people. The Montana Lottery was created by a vote of the people in 1986. Montanans indicated the desire to participate in a variety of gaming not previously available, gaming that would generate additional revenue for important state programs while maintaining the dignity and integrity of the State.

Throughout its eleven years, the Montana Lottery has worked diligently to meet its mandate—maximizing revenues for the state programs it assists, while keeping in mind the dignity of our great state. We continue to offer a variety of games which appeal to Montanans. We strive to present and market those games in a fun, informational and highly secure manner. All the while, we keep in mind that some citizens of the state do not find Lottery products a form of entertainment that should be offered by a governmental entity.

This makes our mandate difficult, and while we continue to actively promote and market our products, we continue to monitor the reactions of Montanans, those for and against the Lottery. While we are charged with maximizing revenues, we realize we must do so in a tasteful manner.

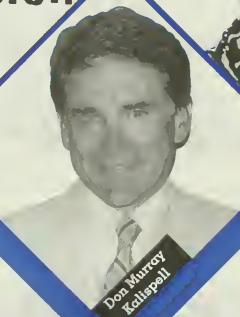
The recent initiative to repeal the Lottery, I-133, which failed to make the ballot, demonstrates Montanans' continued desire for a Lottery and its variety of products. We appreciate the continued support of our players, the retailers who sell our products, our commissioners, and those who, for whatever reason, may not play our games but find the operation of a Lottery in the best interest of the State of Montana. We are encouraged by the successes we experienced this past year, particularly in our Scratch products, and look forward to continued success while we face the challenges of the next year.

With regards,

Gerald J. LaChere

Gerald J. LaChere
Director

Lottery Commission



The Montana State Lottery
the state appointed by the
the Lottery.

Commission is composed
Governor to serve as a policy-

of citizens of
making board for

Our members include an attorney, a certified public accountant, and a law enforcement officer. Two other members are appointed at-large.

We are pleased with the focus Director LaChere and his talented, dedicated staff have taken this past year. Our growth in the Scratch products and the continual research on new products will serve the Lottery and the people of Montana well into the future.

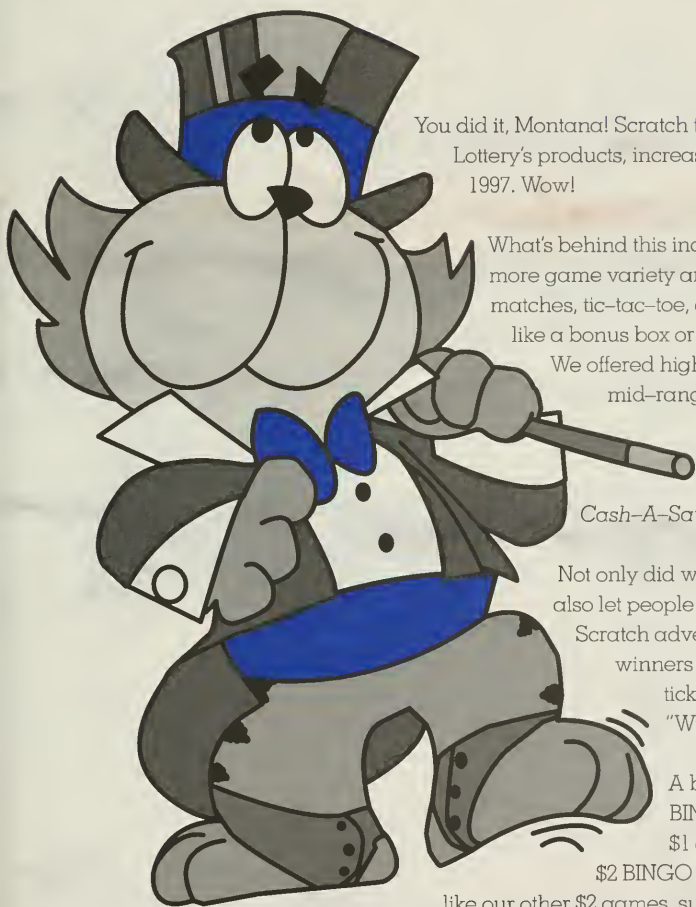
We look forward to working with the Governor, the legislature, the director, and the staff as we chart the future of Montana's own Lottery.

Sincerely,

Becky Erickson

Becky Erickson
Chair

Scratch Sales Straight Up!



You did it, Montana! Scratch tickets, which have been a staple of the Lottery's products, increased in sales by 28 percent over fiscal year 1997. Wow!

What's behind this increase? Our players said they wanted more game variety and more play styles—match three, symbol matches, tic-tac-toe, and add 'em up, or added value features like a bonus box or more chances to win. And we responded.

We offered higher top prizes, more significant wins in the mid-range, and lots and lots of lower prizes. We designed tickets with card and gaming themes, state and sporting themes, and tickets with adorable graphics such as *Cash-A-Saurus*, *Quack Cash* and *Stinkin' Rich*.

Not only did we offer fun games for people to play, we also let people know about the winning experiences. Our Scratch advertising focused on our winners—the big winners and those who won a few dollars or a free ticket. All our advertising said, loud and clear, "Win at your own game."

A big seller this year was our popular BINGO game. While some players prefer the \$1 games, a number of players prefer our \$2 BINGO games. And there are also players who like our other \$2 games, such as *Lucky Times Ten*, *Cash Combination* and *Five Card Cash*. These games, which are called "extended play," take longer to play. And we're finding that feature is attractive to some players.

What's next? We will continue to keep our finger on the pulse of our players and ask them what they want. Then we will continually innovate fun new ideas and offer them to our players, so everyone who wants to play Scratch can "Win at your own game."



The Lotto Games

MONTANA POWERBALL

- Powerball players played for a record POWERBALL jackpot of \$195 million. Over one million Powerball plays were sold in Montana for the May 23, 1998 drawing
- Powerball sales helped drive the Lottery's largest quarterly transfer since fiscal year 1995
- Powerball was revamped and reintroduced in fiscal year 1998. Changes include

- An increase in the minimum jackpot from \$5 million to \$10 million
- Players can choose a Cash Option top prize, which will pay approximately one-half the advertised jackpot amount
- Players who choose the Annuity Option and win the jackpot will receive twenty-five annual payments instead of twenty in the old Powerball game
- Players can choose five numbers from a field of 49, plus one number, the Powerball, from a field of 42
- Low tier prize payout amounts were increased
- The changes were designed to make the jackpot grow bigger

- The jackpot odds increased from 1:55 million to 1:80 million
- The overall odds remain unchanged, at approximately 1:35
- The game is played in 20 other lottery jurisdictions

MONTANA CASH

- Introduced in May 1991
- Players can select five numbers from a field of 37 or play Quick Pick
- Players get two sets of five numbers for each dollar played
- MONTANA CASH is a favorite among many Montana players
- The jackpot starts at \$20,000 and grows until someone matches all five winning numbers
- Players win \$200 for matching four of five numbers
- Players also win \$5 for matching three of five numbers
- Overall odds are approximately 1:43



MONTANA WILD CARD

♥ ♣ ♦ ♠

- Wild Card is a multi-state game played in Montana, Idaho, Nebraska and South Dakota
- It was introduced on February 2, 1998
- The game replaced Tri-West Lotto, which was played in Montana, Idaho and South Dakota
- Players select six numbers out of 38, or they can play "Quick Pick" where the computer selects six numbers
- In addition, the computer deals each play one WILD CARD from a deck of 52 cards
- Match three, four or five numbers and win \$2, \$20, or \$500
- Match the WILD CARD and three, four or five numbers and the prize increases significantly
 - \$2 becomes \$5
 - \$20 becomes \$100
 - \$500 becomes \$25,000!
- AND you don't need the WILD CARD to win the jackpot!
- Jackpots start at \$200,000
- Overall odds are approximately 1:17

Cash 4 Life

MONTANA

- This new daily game replaced Daily Millions on March 30, 1998
- Ten other lotteries offer Cash 4 Life to their players
- Players can win \$1,000 a week for life
- Other top prizes include \$100,000, \$50,000 and \$25,000
- Players also win \$20 for matching three numbers in a set of four
- Players win \$1 for matching two numbers in a set of four
- There are fifteen chances to win on each ticket
- Players can choose their own numbers for the Cash 4 Life prize group
- Each ticket contains two sets of four Quick Pick numbers in the \$100,000 prize group
- Each ticket contains four sets of Quick Picks in the \$50,000 prize group
- Another eight sets of Quick Picks give each ticket eight chances to win \$25,000
- Overall odds in Cash 4 Life are approximately 1:9.9
- Except for the Lifetime Grand Prize, the prizes are all cash prizes
- Drawings are held every night



Independent Auditor's Report

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the accompanying financial statements of Montana State Lottery (Lottery), an enterprise fund of the State of Montana, as of and for the years ended June 30, 1998 and 1997. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Montana State Lottery and are not intended to present the financial position of the State of Montana and the results of its operations and cash flows of its proprietary fund types and nonexpendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery, an enterprise fund of the State of Montana, as of June 30, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 15 to the financial statements, the Lottery was required to change its fixed asset capitalization policy from \$1,000 to \$5,000 by the State of Montana.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 3, 1998 on our consideration of the State of Montana's internal control over financial reporting as it relates to the Montana State Lottery and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

O'Leary & Associates, PC
September 3, 1998

Balance Sheets

June 30, 1998 and 1997

	1998	1997
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (note 2)	\$ 2,945,221	\$ 2,232,830
Accounts receivable, less allowance for doubtful receivables of \$2,445 in 1998 and \$8,768 in 1997	955,814	926,943
Inventory	314,447	501,464
Other current assets (note 3)	<u>266,888</u>	<u>81,072</u>
TOTAL CURRENT ASSETS	<u>4,482,370</u>	<u>3,742,309</u>
FIXED ASSETS		
Furniture, fixtures and equipment	567,125	703,509
Accumulated depreciation and amortization	<u>(395,821)</u>	<u>(425,707)</u>
	<u>171,304</u>	<u>277,802</u>
OTHER ASSETS		
Long-term receivable (note 4)	<u>1,880,647</u>	<u>1,846,016</u>
	<u>\$ 6,534,321</u>	<u>\$ 5,866,127</u>
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 257,704	\$ 399,680
Estimated prize liability (note 5)	1,447,023	1,312,993
Transfer obligations (note 6)	2,259,184	1,741,375
Other current liabilities (note 7)	<u>398,446</u>	<u>267,925</u>
TOTAL CURRENT LIABILITIES	<u>4,362,357</u>	<u>3,721,973</u>
LONG-TERM LIABILITIES (note 8)	<u>1,934,281</u>	<u>1,905,111</u>
	<u>6,296,638</u>	<u>5,627,084</u>
FUND EQUITY		
Contributed capital (note 10)	<u>237,683</u>	<u>239,043</u>
COMMITMENTS AND CONTINGENCIES (notes 9 and 13)	<u>—</u>	<u>—</u>
	<u>\$ 6,534,321</u>	<u>\$ 5,866,127</u>

See notes to financial statements.

Statements of Revenues, Expenses and Changes in Retained Earnings

Years ended June 30, 1998 and 1997

	1998	1997
OPERATING REVENUES		
Instant ticket games	\$ 7,747,761	\$ 6,063,023
On-line games	22,027,399	22,134,337
Miscellaneous	86,329	95,833
TOTAL OPERATING REVENUES	29,861,489	28,293,193
COST OF TICKET REVENUES		
Instant ticket prize expense	4,628,726	3,523,744
On-line ticket prize expense	10,610,680	10,808,835
Retailer commission	1,731,700	1,545,518
On-line vendor fees	2,769,047	2,594,942
Cost of tickets sold	627,641	415,472
TOTAL COST OF TICKET REVENUES	20,367,794	18,888,511
NET OPERATING REVENUES	9,493,695	9,404,682
OPERATING EXPENSES		
Advertising	640,454	688,342
Advertising production	131,433	188,343
Audit fees	35,354	54,740
Communications	137,796	145,497
Contractual services	166,715	139,143
Depreciation	58,939	96,633
Management fees	117,119	93,456
Multi-state operating fees	101,277	72,350
Other	45,248	65,012
Personal services	1,290,089	1,151,566
Repairs and maintenance	50,067	44,239
Supplies and materials	161,110	148,911
Utilities and rent	95,186	94,238
Travel	25,795	24,613
TOTAL OPERATING EXPENSES	3,056,582	3,007,083
OPERATING INCOME	6,437,113	6,397,599

See notes to financial statements.

Statements of Revenues, Expenses and Changes in Retained Earnings—cont.

Years ended June 30, 1998 and 1997

	1998	1997
NONOPERATING REVENUES (EXPENSES)		
Interest income	250,986	211,662
Security lending income	6,125	7,573
Security lending costs	(5,975)	(7,165)
Loss on disposal of fixed assets	—	(6,409)
	<u>251,136</u>	<u>205,661</u>
TOTAL NONOPERATING REVENUES (EXPENSES)		
	<u>251,136</u>	<u>205,661</u>
INCOME BEFORE OPERATING TRANSFERS	<u>6,688,249</u>	<u>6,603,260</u>
OPERATING TRANSFERS OUT		
General Fund	6,569,565	6,603,260
Study of the Socioeconomic Impacts of Gambling Fund	<u>52,708</u>	<u>—</u>
	<u>6,622,273</u>	<u>6,603,260</u>
TOTAL OPERATING TRANSFERS OUT		
	<u>6,622,273</u>	<u>6,603,260</u>
INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	<u>65,976</u>	<u>—</u>
CUMULATIVE EFFECT ON PRIOR YEARS OF ACCOUNTING CHANGE	<u>(65,976)</u>	<u>—</u>
NET INCOME (LOSS)	<u>—</u>	<u>—</u>
RETAINED EARNINGS, BEGINNING OF YEAR	<u>—</u>	<u>—</u>
RETAINED EARNINGS, END OF YEAR	<u>\$ —</u>	<u>\$ —</u>

See notes to financial statements.

Statements of Cash Flows

Years ended June 30, 1998 and 1997

	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from sales	\$ 29,842,806	\$ 27,959,571
Cash paid to suppliers for goods and services	(6,835,260)	(6,592,907)
Cash paid to employees	(1,316,287)	(1,150,158)
Cash paid for prizes	(15,088,900)	(14,141,738)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>6,602,359</u>	<u>6,074,768</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating transfers out:		
General Fund	(6,051,756)	(6,507,016)
Study of the Socioeconomic Impacts of Gambling Fund	(52,708)	—
NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES	<u>(6,104,464)</u>	<u>(6,507,016)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of fixed assets	(36,640)	(29,215)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(36,640)</u>	<u>(29,215)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received on investments	250,986	211,663
Security lending income	6,125	7,573
Security lending costs	(5,975)	(7,165)
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>251,136</u>	<u>212,071</u>
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	712,391	(249,392)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>2,232,830</u>	<u>2,482,222</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 2,945,221</u>	<u>\$ 2,232,830</u>

See notes to financial statements.

Statements of Cash Flows—Cont.

Years ended June 30, 1998 and 1997

Reconciliation of Operating Income to Net Cash Provided by Operating Activities

	1998	1997
Operating income	\$ 6,437,113	\$ 6,397,599
Adjustment to reconcile operating income to net cash provided by operating activities		
Depreciation	58,939	96,633
Changes in assets and liabilities		
Increase in accounts receivable	(28,871)	(163,571)
(Increase)/decrease in inventory	187,017	(334,501)
(Increase)/decrease in other current assets	(185,815)	39,145
Increase in long-term receivable	(34,631)	(124,951)
Increase/(decrease) in accounts payable	(125,113)	78,015
Increase in estimated prize liability	134,030	104,137
Increase/(decrease) in other current liabilities	130,520	(102,553)
Increase in long-term liabilities	29,170	84,815
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 6,602,359</u>	<u>\$ 6,074,768</u>

Notes to Financial Statements

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana. Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Montana Department of Commerce for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commissions to sales agents. The remaining revenue, less operating expenses, is transferred to the Montana State General Fund. Section 23-7-401(5), MCA, states that for the purposes of funding a study of the socioeconomic impacts of gambling, \$100,000 of Lottery net revenue may be appropriated during the biennium ending June 30, 1999. \$52,708 of net revenue was utilized to fund the study during fiscal year 1998 and is reflected in the financial statements as an operating transfer out.

Reporting Entity

The Lottery is included in the State of Montana's financial statements as an enterprise fund. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting

The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition

Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when tickets are activated by retailers. Tickets activated, but not sold by retailers, may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

Cash and Cash Equivalents

Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash deposited with banks and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Inventory

Inventories consist of tickets and supplies. Ticket inventory includes instant lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when activated. Unsold tickets are charged to cost of sales upon the end or cancellation of the related game. Supply inventory is carried at cost and expensed as used.

Prizes

Prepaid prizes represent prizes purchased and on-hand in advance of game awards. Prize expense is recognized based on a predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

Intangible Assets

Intangible assets represent the per ticket cost paid to Automated Wagering Inc. for advance on-line ticket sales. These ticket sales, also referred to as deferred revenue, represent tickets sold prior to June 30, 1998 and 1997 for drawings held subsequent to year-end.

Fixed Assets

Fixed assets are recorded at cost. Donated fixed assets are recorded at their estimated fair market value at the date of donation. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are



capitalized. Upon disposition or retirement of fixed assets, the cost and related accumulated depreciation or amortization is removed from the accounts. Gain or loss on disposal is reflected in nonoperating revenues and expenses. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of two to ten years.

Contributed Capital

Contributed capital represents equity acquired through contributions from vendors and the State of Montana.

Compensated Absences

State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed twice the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Reclassifications

Certain reclassifications have been made to the 1997 financial statements in order to conform to the 1998 presentation.

NOTE 2 — CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>June 30,</u>	
	<u>1998</u>	<u>1997</u>
Short-term investment pool	\$2,901,850	\$1,621,145
Cash on deposit with State Treasurer	33,221	601,535
Cash in revolving deposit account	10,000	10,000
Petty cash	<u>150</u>	<u>150</u>
	<u>\$2,945,221</u>	<u>\$2,232,830</u>

Reference to the audit of the State of Montana would identify GASB No. 28 disclosures and the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was \$15,663 and \$10,336 at June 30, 1998 and 1997, respectively, and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

NOTE 3 — OTHER CURRENT ASSETS

Other current assets consist of the following:

	<u>June 30,</u>	
	<u>1998</u>	<u>1997</u>
Cash collateral – security lending transactions	\$ 194,340	\$ 43,646
Prepaid prizes and expenses	42,442	10,546
Intangible assets	13,246	9,665
Due from other state agencies	11,810	12,665
Employee advances	<u>5,050</u>	<u>4,550</u>
	<u>\$ 266,888</u>	<u>\$ 81,072</u>

NOTE 4 — MULTI-STATE LOTTERY ASSOCIATION

Joint Venture Association

In November 1989, the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Lotto*America/Powerball game, Wild Card game and Cash 4 Life game are presently the only games operated jointly by the members. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Payable

As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted and the related interest earnings will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which may have been paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of \$1,880,647 and \$1,846,016 at June 30, 1998 and 1997, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of \$94,131,232 and \$92,733,659 for 1998 and 1997, respectively. The long-term liability balance of \$1,755,908 and \$1,739,432 at June 30, 1998 and 1997, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto* America Prizes and Investments

Prizes awarded to Lotto* America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Montana State Lottery and distributed to the grand prize winners on the anniversary date of each win.

At June 30, 1998 and 1997, MUSL held United States Government zero coupon bonds in trust for the Montana State Lottery winners with respective par values of \$75,997,948 and \$81,206,123 and respective market values of \$51,878,911 and \$50,924,260.

The Montana State Lottery has eight Lotto* America/Powerball/Tri-West winners. The combined total of future prize payments owed is \$75,997,000 and \$81,205,000 at June 30, 1998 and 1997, respectively. Total annual payments due over each of the next five years is \$5,208,000 annually and \$49,957,000 thereafter. The present value of future prize payments approximates the current market value of the bonds held in trust for the Montana State Lottery winners.

Multi-State Lottery Association Financial Position

Information related to the Multi-State Lottery Association's audited financial statements is as follows:

	<u>June 30,</u>	
	<u>1998</u>	<u>1997</u>
Total assets	<u>\$1,655,688,518</u>	<u>\$1,437,619,763</u>
Total liabilities	1,655,424,985	1,437,328,433
Total net assets	<u>263,533</u>	<u>291,330</u>
Total liabilities and net assets, unrestricted	<u>\$1,655,688,518</u>	<u>\$1,437,619,763</u>
Total revenues	\$ 3,123,770	\$ 3,175,623
Total expenses	<u>3,151,567</u>	<u>3,100,012</u>
Increase (decrease) in unrestricted net assets	<u>\$ (27,797)</u>	<u>\$ 75,611</u>

NOTE 5 — ESTIMATED PRIZE LIABILITY

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

NOTE 6 — OBLIGATION TO TRANSFER FUNDS

The Montana State Lottery is required to transfer its net revenue to the Montana State General Fund. This change was enacted through the passage of SB 83 by the 1995 Legislature and signed into law by Governor Racicot in April 1995. Transfer obligations outstanding at June 30, 1998 and 1997 were \$2,259,184 and \$1,741,375, respectively.

NOTE 7 — OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	<u>June 30,</u>	
	<u>1998</u>	<u>1997</u>
Due to other state agencies	\$ 61,681	\$120,350
Liability under security lending transactions	194,340	43,646
Deferred on-line revenue	<u>142,425</u>	<u>103,929</u>
	<u>\$398,446</u>	<u>\$267,925</u>

NOTE 8 — LONG-TERM LIABILITIES

Long-term liabilities consist of the following:

	<u>June 30,</u>	
	<u>1998</u>	<u>1997</u>
Prize liability Multi-State Lottery Association	\$1,755,908	\$1,739,432
Accrued compensated absences	<u>178,373</u>	<u>165,679</u>
	<u>\$1,934,281</u>	<u>\$1,905,111</u>

NOTE 9 — LEASES

The Lottery leases its office, administrative and warehouse facilities under a lease agreement expiring February 2002. Rent expense under operating leases charged to operations was \$78,000 for the years ended June 30, 1998 and 1997.



NOTE 10 — CONTRIBUTED CAPITAL

Contributed capital decreased \$1,360 during 1998. The decrease is related to the State of Montana changing its fixed asset capitalization policy from \$1,000 to \$5,000.

NOTE 11 — EMPLOYEE BENEFIT PLANS

Pension Plan

The Lottery participates in the Public Employees Retirement System (PERS). PERS is a statewide mandatory cost-sharing multiple employer defined benefit retirement plan which covers all employees. The plan is established under State law and is administered by the State of Montana. The plan provides retirement, disability, and death benefits to plan members and beneficiaries.

The plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from the following address: Public Employees Retirement System, Public Employees Retirement Division, P.O. Box 200131, 1712 Ninth Avenue, Helena, MT 59620-0131, (406) 444-3154.

Contribution rates for the plan are required and determined by State law. The contribution rate for 1998, expressed as a percentage of covered payroll, was 6.7% for the employer. Effective July 1, 1997, the contribution rate for 1998, expressed as a percentage of covered payroll, increased from 6.7% to 6.8% for employees.

The amounts contributed to the plan during the years ended June 30, 1998, 1997 and 1996, were \$130,220, \$115,558 and \$117,222, respectively, and were equal to the required contributions for each year.

Deferred Compensation Plan

The Lottery's permanent employees are eligible to participate in the State of Montana's deferred compensation plan. The plan is administered by Benefits Corporation on behalf of Great West Life Insurance Company through a contract with the State of Montana. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts deferred under the plan created under Internal Revenue Code Section 457 remain the property of the State of Montana until paid, subject only to claims of the State of Montana's general creditors. Participants' rights under the plan are equal to those of general creditors of the State of Montana in an amount equal to the fair market value of the deferred account for each participant.

NOTE 12 — RELATED PARTY TRANSACTIONS

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 1998 and 1997, total payments to other State agencies were approximately \$313,000 and \$319,000, respectively.

NOTE 13 — COMMITMENTS AND CONTINGENCIES

Instant Tickets

The Lottery has an agreement with BAEN Technologies Corporation to print instant game tickets. The agreement expires June 30, 2001.

Maintenance Contract

The Lottery has an agreement with Stratus Computer, Inc. to provide for computer hardware and software maintenance. The agreement provides for quarterly payments of \$9,587. The agreement may be canceled by either party with proper notification.

On-line Vendor

The Lottery is contracted with Automated Wagering to provide for the operation of an on-line gaming system through March 29, 1999.

Advertising

The Lottery signed a contract with Banik & Associates to provide advertising services for \$8,400 per month through December 1999.

Independent observation of drawings

Lottery is committed to Henry Fenton, CPA, to observe Montana Cash and other special drawings. The term of the contract is for one year ending June 30, 1999. Compensation will not exceed \$9,675.

Prize Contingencies

Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of \$2,234,559 and \$2,484,559 at June 30, 1998 and 1997, respectively, if the insurance carrier defaulted on their payments.



Litigation

The Lottery is involved in two legal actions arising in the normal course of business. The Lottery intends to vigorously defend these actions. In the opinion of management and legal counsel, such matters will not have a material effect upon the financial position or results of operations of the Lottery.

NOTE 14 — SUBSEQUENT EVENT

On August 18, 1998, the Lottery signed a seven year contract with Autotote Lottery Corporation to provide an on-line gaming system and associated services beginning no later than March 1999. The contract provides for payments to be made for the purchase of equipment as well as payments to be made based on a percentage of weekly Lottery sales. The estimated total contract price is approximately \$24 million over the seven years of the contract.

NOTE 15 — CUMULATIVE EFFECT ON PRIOR YEARS OF ACCOUNTING CHANGE

Effective July 1, 1997, the Lottery was required to change its fixed asset capitalization policy from \$1,000 to \$5,000 by the State of Montana. This change in accounting principle resulted in a charge to net income of \$65,976 for the year ended June 30, 1998.

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